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C O N F I D E N T I A L SECTION 01 OF 03 TAIPEI 001421

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USTR, USTR FOR KI AND FREEMAN, USDOC FOR
4431/ITA/MAC/APOPB/MBMORGAN AND
3132/USFCS/OIO/EAP/ABACHER/ADESARRAN AND USDA FOR FAS/ITP,
GENEVA FOR USTR

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SUBJECT: PROCUREMENT STILL A CHALLENGE IN TAIWAN

Classified By: AIT DIRECTOR DOUGLAS PAAL FOR REASONS 1.4 (B/D)

1. (U) Summary: The public procurement process in Taiwan remains a longstanding irritant for US firms. Several recent cases of US firms running into problems with the procurement process, including allegations of improper political influence in the tendering process, indicate that this issue should be raised at the upcoming trade talks scheduled for March 30-31. End Summary.

Problems in Public Procurement

2. (U) Public procurement has been a longstanding irritant for the US business community in Taiwan. The American Chamber of Commerce has regularly been, in the words of its Executive Director, "beating its head against the wall" on this issue for well over a decade. In recent months, the Chamber has dramatically lowered its expectations on this issue. Observing that the Construction Committee of the Chamber has all but disbanded and that its most active member is Germany's Siemens Corporation, the ED said most of the US construction and engineering industry has left Taiwan (bound for Mainland China) because the firms believe that they have little or no chance of winning any contracts on the island because of non-transparency in the procurement process. While there was some hope that things would improve with Taiwan's accession to the WTO in 2002 and its commitment to join the WTO Agreement on Government Procurement (GPA) and/or unilaterally abide by the GPA terms and conditions, many of those expectations have dissipated.

3. (U) Even if the Chamber is currently giving procurement a low priority, AIT/T believes we should continue to pursue this issue in an effort to increase the transparency of public procurement in Taiwan. Any progress we can make in this area could provide increased business opportunities in Taiwan for US firms and highlight the need for Taiwan to adhere to its international trade commitments. In the past few weeks some significant complaints have arisen about the procurement process, enabling us to gather some specific details about current cases of interest to US firms. Taiwan business circles are often awash in rumor and innuendo about shady procurement practices, but details are generally hard to come by and even harder to confirm.

Concerns over Terms, Administration and Appeals

4. (U) Generally speaking, US firms' complaints with Taiwan's public procurement process fall into three areas: the terms and conditions (such as unlimited liability), non-transparent procurement administration and the appeals process. Contract terms and conditions are often thought to be egregiously onerous, leading many US firms simply not to bid on the project at all. U.S. firms often compare "Ts & Cs" in Taiwan public tenders unfavorably with those in PRC tenders. Many RFPs come with an unlimited contingent liability clause that gives pause to the legal departments of virtually all US international firms. Several firms have commented that their legal departments simply reject submitting a bid based on a review of the RFP documents. One local example of why unlimited liability has such a chilling effect: last year during one of the many typhoons that hit Taiwan, floodwaters reached and flowed through a drainage culvert being built under the Danshui River for the subway system. The result was severe flooding in Sanchong city, an area that had not been hit by floods for some 26 years. It is still not clear who is responsible for footing the cleanup bill and for compensating the tens of thousands Sanchong residents affected by the flood, but US firms are rightly wary of entering into any contract that might involve such open-ended commitments. Procurement administration, including technical evaluation of proposals, is frequently criticized as highly non-transparent and unpredictable. U.S. firms attribute this in part to shortcomings in Taiwan's Government Procurement Law (GPL), which it follows in lieu of the WTO GPA. Finally, the appeals process is handled by the Public Construction Commission (PCC) and is widely criticized by international bidders as non-transparent. One U.S.

company recently provided details on its case that is under mediation. In short, the U.S. firm believes that a government ministry was actively working to rig the mediation process.

15. (SBU) AIT/T recommends that procurement concerns be raised during the upcoming trade consultations scheduled for March 30-31 in Taipei. AIT consultants from USTR and AIT/W could usefully note concerns on procurement and ask that Taiwan officials work with AIT/T to see if we can make some progress in this area.

Stone & Webster

16. (C) AIT/T met with Stone & Webster on March 21 (as we had in November 2004) to discuss its concerns about Taiwan legislators playing a major role in influencing procurement decisions on the 4th Nuclear Power Plant project. Stone & Webster is a US engineering firm with the contract to conduct architectural and engineering work on 4NNP. Under the terms of its contract Stone & Webster writes specifications and evaluates bids for various suppliers and subcontractors. In the meeting and in a letter dated March 21, 2005, Stone & Webster detailed a history of pressure tactics utilized by Taiwan Legislative Yuan members (from the DPP) on Taiwan Power Company (TPC) executives and directly with Stone & Webster officers to influence contract awards. The history of pressure tactics, including holding public hearings and accusing Stone & Webster of violating various sections of Taiwan's procurement law; TPC officials seeking Stone & Webster cooperation to direct contracts to certain firms while refusing to allow minutes of the meetings to be taken; TPC reprimands for Stone & Webster not accommodating TPC's positions;⁸ and, most recently, threats of physical violence and police investigations against Stone & Webster employees. Stone & Webster assured us that it has refused to participate in any bid-rigging activities despite explicit requests from lawmakers and TPC officials to do so. Further, it believes the situation may be resolvable with TPC, but it wanted to share its concerns with us over the procurement process should the situation deteriorate any further.

Holtec & Duratek

17. (SBU) Holtec and Duratek bid on separate tenders from, again, TPC, to build nuclear waste storage facilities. Neither firm won the contract they bid on. The likely winner in both cases will be INER (the Institute of Nuclear Energy Research) - a Taiwan state-owned entity. There is some history to these tenders. TPC had issued tenders on the same projects and received international bids substantially above TPC's budget for the project. As such the contract was withdrawn and now reissued for another round of bidding. In the current scenario, INER has bid on the projects at a price well below Holtec's and Duratek's. Under the terms of Taiwan's government procurement law, in the absence of qualified⁸ international bids (i.e., coming in at or lower than TPC's budgeted amount), INER, with no experience in the field, gets the contract.

18. (C) The US firms allege that TPC's budget for the projects is unrealistically low and the entire tendering process is simply a vehicle to deliver the contract to a local firm, in this case INER. Many US firms suggest that the larger goal for Taiwan officials is to help develop specific technologies indigenously through guiding contracts to local firms while shutting out foreign competition. These two firms have both sought assistance from the USDOC Advocacy Center and at least Duratek has filed an appeal to the PCC. AIT/T will continue to press the cases for Holtec and Duratek. Unfortunately, in our experience, the PCC has been quite reluctant to intervene in procurement decisions absent a clear violation of the law. Even more unfortunate, PCC rulings are advisory only. They have no enforcement mechanism. After filing the appeal, Duratek told us that it will simply walk away if the PCC does not provide satisfaction because "it can get much more business in China than in Taiwan for the same amount of aggravation."

IBM

19. (C) Robert Huang, head of IBM Taiwan has advised AIT/T of concerns about Taiwan requirements that government procurement contracts include provisions that the buyer owns all the rights to the intellectual property in the product. Huang says that this provision prevents his company from bidding on a number of potentially desirable tenders. It also allows the buyer to make its own modifications and distribute software as widely as it wants to potential users, thus eliminating future profits for the software designer. He views this provision as an effort to, again, steer contracts to local suppliers and shut out foreign bidders. Huang has made significant efforts on his own to argue the

merits of this provision with Taiwan officials, including meeting with the PCC and economic officials.

Comment

110. (C) There is no shortage of other allegations of impropriety in contract awards in Taiwan. The cases above provide a degree of specificity that is generally not available when claims and counterclaims are made about influence peddling. The High Speed Rail system (THSR) is a good example of the rumor mill in operation. THSR is due to start operation in October this year, yet it is several billion NT\$ short of funds to finish the project and the general expectation is that it will not meet its start-up target. One consistent allegation about the project is that it backtracked on the original contract award to European firms due to political pressure from the Taiwan Solidarity Union (TSU), a small pro-independence ally of the ruling Democratic Progressive Party (DPP), that favored awarding the contract to Japanese firms. While no one wants to go on the record on this allegation of political meddling, it is public knowledge that THSR has paid the European consortium a US\$140 million fee for backing out of the original contract. Similarly, Taiwan paid a heavy financial (as well as political) price for stopping 4NPP in 2000. These same excessive costs continue today as Stone & Webster reports that TPC is racking up large financial costs in its repeated delays of contract awards for the 4NPP.

111. (C) These costs impose a significant burden on Taiwan's economic and political institutions. Under the single-party rule of the KMT in Taiwan, there were regular allegations of a lack of transparency in procurement processes and business operations in General. The DPP has billed itself as, and was initially accepted as, the party of reform willing and able to root out corruption and inefficiency. In financial circles, the DPP has proclaimed itself as intent on financial-sector reform aimed at producing a more open, market-based financial industry. The DPP implemented on July 1, 2004 the Financial Supervisory Commission to provide a stronger, unified regulatory system for the financial sector. We think that it is appropriate to urge Taiwan to implement these same kinds of commitments to its public procurement policy. End comment.

PAAL